



THE CITY OF SAN DIEGO

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**OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT**

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**Date Issued:** May 3, 2018


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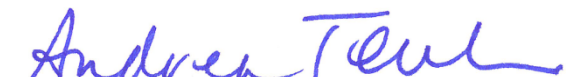
**Budget Review Committee Docket Date:** May 7, 2018

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## **Review of City Agencies FY 2019 Budgets: Convention Center**

The IBA has reviewed the San Diego Convention Center Corporation (SDCCC) proposed budget which is scheduled to be heard Monday, May 7, 2018. Our review is attached.

  
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Deputy Director

  
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Independent Budget Analyst

# Convention Center

## Overview

The San Diego Convention Center Corporation (SDCCC) is a non-profit public benefit corporation created by the City to manage, market, and operate the San Diego Convention Center. A seven-member Board of Directors (Board) comprised of business and community leaders establishes policy for the SDCCC.

The mission of SDCCC is to “generate significant economic benefits for the greater San Diego region by hosting international and national conventions and trade shows in our world-class facility.”

SDCCC provides operating and economic performance measures to reflect the economic benefits resulting from Convention Center operations. These projections were updated on April 16, 2018. Estimated and projected performance measures for fiscal years 2017, 2018, and 2019 are shown in the table below. These measures were developed based on information and research provided by Destination Marketing Association International and CIC Research, Inc.

In recent years (notably FY 2017), most of these measures were at, or very near, all-time highs. Fewer conventions are projected in FY 2018 which translates to an expectation for slightly reduced performance measures in FY 2018 although sev-

eral measures are projected to be very strong in FY 2019.

If voters support a measure to expand the Convention Center in November 2018, there will be opportunities to significantly increase the number and size of events, and these performance metrics.

## FY 2019 Proposed Budget

On March 21, 2018, the SDCCC Board reviewed and approved a budget for FY 2019. The budget is available at <https://visitsandiego.com/about/current-budget>. A comparison of this budget to SDCCC’s FY 2018 budget is provided in the Summary of Budget Changes table on the following page.

The FY 2019 expenditure budget for the Convention Center is approximately \$42.4 million, an increase of \$3.8 million or 9.9% over the FY 2018 Budget.

## Personnel Expense/Staffing

The FY 2019 budget includes total personnel expenses of \$24.2 million, an increase of approximately \$2.3 million or 10.6% over the FY 2018 budget. This increase is largely explained by \$1.8 million of salary and wage increases (including collective bargaining step increases and merit and other increases for non-represented staff) and \$537,000 for increased fringe benefit costs (health, pension, and other).

Estimated and Projected Benefits from Operations,	FY 2017	FY 2018	FY 2019
• Regional Economic Impact	\$1.1 billion	\$1.1 billion	\$1.3 billion
• Direct Attendee Spending	\$673.9 million	\$660.2 million	\$787.3 million
• Hotel & Sales Tax Revenue	\$25.4 million	\$25.0 million	\$30.6 million
• Hotel Room Nights	844,382	694,000	827,000
• Building Occupancy	76.0%	71.4%	75.8%
• Number of Conventions and Events	149	130	97
• Attendance – Primary Business Attendees	676,850	553,000	628,000

<sup>1)</sup> FY 2017 data based on SDCCC FY 17 Annual Report. FY 2018 and FY 2019 data estimated by SDCCC as of April 16, 2018.

## City Agencies: Convention Center

# Convention Center

SUMMARY OF CONVENTION CENTER BUDGET CHANGES					
	FY 2017 Budget	FY 2018 Budget	FY 2019 Budget	Increase/ (Decrease)*	Percent Change*
<b>REVENUES</b>					
Building Rent (net of rent credits)	\$9,219,119	\$8,726,398	\$9,510,829	\$784,431	9.0%
Co-Promoted Events	-	400,000	300,000	(100,000)	-25.0%
Food and Beverage	10,399,604	9,828,167	11,793,253	\$1,965,086	20.0%
Event Services	3,777,774	4,003,715	4,911,228	907,513	22.7%
Utilities	4,439,530	4,926,921	6,418,337	1,491,416	30.3%
Telecommunications	3,479,031	3,457,934	4,636,945	1,179,011	34.1%
Audio & Visual Services	1,161,400	1,432,170	1,287,350	(144,820)	-10.1%
Naming Rights & Sponsorships	-	150,000	160,000	10,000	6.7%
Interest & Other	102,500	260,866	347,646	86,780	33.3%
City of San Diego	3,436,000	3,436,000	2,133,025	(1,302,975)	-37.9%
<b>TOTAL REVENUES</b>	<b>\$36,014,958</b>	<b>\$36,622,171</b>	<b>\$41,498,613</b>	<b>\$4,876,442</b>	<b>13.3%</b>
<b>EXPENSES</b>					
Salaries and Wages	\$16,114,038	\$16,709,696	\$18,491,192	\$1,781,496	10.7%
Overtime	114,144	102,138	105,852	3,714	3.6%
Fringe Benefits (Health)	2,144,500	2,040,439	2,314,566	274,127	13.4%
Fringe Benefits (Pension)	2,272,281	2,372,890	2,560,791	187,901	7.9%
Fringe Benefits (Other)	662,695	642,408	717,281	74,873	11.7%
<b>Subtotal Personnel Expenses:</b>	<b>\$21,307,658</b>	<b>\$21,867,571</b>	<b>\$24,189,682</b>	<b>\$2,322,111</b>	<b>10.6%</b>
General Expenses	\$1,081,933	\$2,822,575	\$2,473,482	(\$349,093)	-12.4%
Repair and Maintenance	2,814,353	2,970,124	2,741,523	(228,601)	-7.7%
Utilities	4,253,475	3,913,872	4,038,326	124,454	3.2%
Contracted Services	658,807	759,644	1,255,038	495,394	65.2%
Travel & Transportation	112,167	102,791	156,260	53,469	52.0%
Insurance	369,543	369,126	405,357	36,231	9.8%
Telecommunications	59,395	52,696	44,935	(7,761)	-14.7%
Sales & Marketing	2,053,572	2,087,958	2,310,136	222,178	10.6%
Supplies	670,030	637,460	820,722	183,262	28.7%
<b>Subtotal Non-Personnel Expenses:</b>	<b>\$12,073,275</b>	<b>\$13,716,246</b>	<b>\$14,245,779</b>	<b>\$529,533</b>	<b>3.9%</b>
Depreciation Expense	\$1,818,824	\$2,492,296	\$2,975,660	\$483,364	19.4%
Interest Expense	518,900	451,438	840,450	389,012	86.2%
Loss on Disposal of Fixed Assets	-	2,365	100,000	97,635	4128.3%
Loan Admin Fee	43,400	-	-	-	-
<b>Subtotal Non-Operating Expenses:</b>	<b>\$2,381,124</b>	<b>\$2,946,099</b>	<b>\$3,916,110</b>	<b>\$970,011</b>	<b>32.9%</b>
<b>TOTAL EXPENSES</b>	<b>\$35,762,057</b>	<b>\$38,529,916</b>	<b>\$42,351,571</b>	<b>\$3,821,655</b>	<b>9.9%</b>

\* Increase/(Decrease) and Percent Change are calculated using budgeted numbers for FY 2018 and FY 2019.

# City Agencies: Convention Center

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There are 355.90 FTE positions in the FY 2019 budget, an increase of 34.23 FTE positions as compared to the FY 2018 budget. The addition of 34.23 positions is the sum result of adding 5.00 Managers, 4.17 salaried employees, 27.81 hourly part-time employees, and a partially offsetting reduction of (0.75) Director, (1.00) Supervisor, and (1.00) hourly full-time employee.

Of the 355.90 FTE positions in the FY 2019 budget, 220.42 (62%) are full-time staff and 135.48 (38%) are hourly part-time employees. SDCCC staff indicates that 115.00 of the 220.42 full-time staff are represented workers and the remaining 105.42 are unrepresented. Approximately 94% of the 135.48 hourly part-time employees are represented.

## **Non-Personnel Expenses**

Non-Personnel Expenses (NPE) increased by approximately \$530,000 or 3.9%, from \$13.7 million in FY 2018 to \$14.2 million in FY 2019. This year-over-year increase is primarily attributable to changes in the following NPE line items:

General Expenses: Decreased by approximately \$349,000 or 12.4% in FY 2019. The decrease is primarily due to reduced purchases of furniture, fixtures & equipment (FF&E). In FY 2018, there was a one-time increase in this NPE line item to replace worn stacking chairs. This expense is removed in FY 2019.

Repair and Maintenance: The building will continue to be busy and experience additional wear in FY 2019 necessitating repair and maintenance expenditures. Despite this continued need, SDCCC management has been challenged to find opportune times to perform maintenance and repair in the busy facility and this line item of expense has been reduced by \$229,000 or 7.7% in FY 2019.

Contracted Services: This expense category increases by \$495,000 or 65.2% largely due to an increase in Other Professional Services in support of operational and organizational analyses and facility/capital projects consulting. In particular, SDCCC has hired an architectural design firm to develop a plan to upgrade and modernize the facility.

Sales & Marketing: Increases by \$222,000 or 10.6% in FY 19 primarily to reflect the increased annual cost of the recently approved long-term marketing contract with the San Diego Tourism Authority. There is also some new expense for travel to better market the facility.

Supplies: The budget for this line item is increased by \$183,000 or 28.7% mainly to repair and enhance leaking planter boxes at the facility. Part of SDCCC's agreement with the Port requires the maintenance of planter boxes.

## **Non-Operating Expenses**

Non-operating expenses increased by \$970,000 or 32.9% in the FY 2019 budget. This difference is comprised of a \$483,000 increase in depreciation, a \$389,000 increase in interest expense on the I-Bank loan, and \$98,000 of additional loss on disposal of fixed assets.

Depreciation: SDCCC uses full accrual accounting, which differs from the City's practice of using cash-basis accounting for budgeting purposes. Under full accrual accounting, capital assets are capitalized on the balance sheet and depreciated (expensed) over their useful life. Depreciation expense is included in SDCCC's annual income statement. As shown in the Summary of Budget Changes table on page 2, approximately \$3.0 million is budgeted for depreciation in the FY 2019 Proposed Budget.

# City Agencies: Convention Center

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## **Revenue**

Budgeted revenue for the Convention Center increased by approximately \$4.9 million or 13.3% from \$36.6 million in FY 2018 to \$41.5 million in FY 2019. The year-over-year increase in total budgeted revenue is largely results from changes in the following revenue line items:

Net Building Rent: Rent paid for use of the facility, net of rental credits offered as a negotiating incentive to attract business, is projected to increase by \$784,000 or 9.0% in FY 2019. Building rents increased by \$2.2 million over the FY 2018 budget and rental credits for the building increased by \$1.4 million. The difference between these two figures results in the \$784,000 budget increase in FY 2019.

Co-Promoted Events: SDCCC management reevaluated plans to co-promote two events (e.g., music festivals) in FY 2019 with other entities and adjusted their revenue estimate accordingly, resulting in a \$100,000 or 25% reduction from the amount budgeted in FY 2018.

Food & Beverage: When conventions, trade shows, and other corporate events book the facility, they often commit to a guaranteed minimum amount of food & beverage service. Based on this information, SDCCC expects an increase of \$2.0 million or 20% over the amount budgeted in FY 2018.

Event Services: In FY 2018, SDCCC began to directly provide exhibit booth cleaning, advertising, and other billable labor services which resulted in additional revenue. Given the anticipated demand for these services in FY 2019, SDCCC expects revenue to increase by \$908,000 or 22.7% over the amount budgeted in FY 2018.

Utilities: SDCCC provide utility services (e.g., exhibit booth electrical hook-up) to users of the facility and receives a commission for these services. Based on the activity planned for the facility in FY 2019, revenue from utility-related services has been increased by \$1.5 million or 30.3% over the amount budgeted in FY 2018.

Telecommunications: SDCCC has an agreement with Smart City to provide telecommunications services to their clients. Based on the activity planned for the facility in FY 2019, revenue from telecommunications services has been increased by \$1.2 million or 34.1% over the amount budgeted in FY 2018.

City of San Diego: In recent years, the City has provided SDCCC with a \$3.4 million annual support payment to cover the cost of the long-term marketing agreement with SDTA and also address some of the capital needs at the facility. In FY 2019, the City is reducing the support payment to \$2.1 million—an amount sufficient to cover the long-term marketing agreement.

## **Issues to Consider**

### **Unrestricted Net Assets as they relate to SDCCC's Reserve Policy**

On February 5, 2016, the SDCCC Board amended their Reserve Policy. The amended Reserve Policy now calls for a minimum reserve of at least 8%, and a goal of attaining a 14% reserve, measured as a percentage of the most recent three-year average of annual audited operating revenues. The Policy further states that "Operating Reserves will be maintained to mitigate building maintenance, financial and service delivery risk due to unexpected revenue shortfalls or unanticipated critical expenditures and to sustain necessary operations in the case of unforeseen emergencies."

# City Agencies: Convention Center

	FY 2015	FY 2016	FY 2017	FY 2018*	FY 2019*
<b>Actual or Projected* Year-end Unrestricted Net Assets (UNA):</b>	\$6,188,824	\$6,616,675	\$4,631,228	\$5,633,635	\$5,705,971
<b>3-year Average Audited Revenue:</b>	\$32,936,145	\$34,450,003	\$36,945,359	\$37,114,926	\$39,953,351
<b>Actual or Projected* Reserve %:</b>	18.79%	19.21%	12.54%	15.18%	14.28%

The annual audited financial statements for SDCCC provide a Statement of Net Position for the end of each fiscal year. At the bottom of this Statement is a line item entitled “Unrestricted” which represents “Unrestricted Net Assets” (UNA) at year-end. The UNA balance can be considered to be available for any purpose and effectively constitutes a reserve for SDCCC.

The top line of the above table shows actual and projected UNA over a five-year period. The middle line provides the relevant three-year average of annual operating revenues. The bottom line calculates the actual or projected reserve percentages from FY 2015 through FY 2019. Based on current UNA projections, SDCCC would exceed its 14% reserve target in FY 2018 and FY 2019.

### **California Infrastructure Bank (I-Bank) Loan to Finance Needed Capital Projects**

In a collaborative effort with the City, SDCCC finalized the terms of a \$25.5 million I-Bank loan in December 2016. The term of the loan is 25 years and rate of interest is 3.6%.

Beginning in FY 2020, SDCCC will be required to make full annual debt service payments on the loan of approximately \$1.7 million through FY 2041. Because a portion of the debt service prior to FY 2020 was capitalized into the loan, SDCCC’s debt service payment in FY 2019 is only \$840,000.

At least eight major capital projects will be funded with I-Bank loan proceeds. The following five projects, totaling approximately \$18 million, have already been completed:

- Replace Sails Pavilion Fabric Structure (\$10.6 million)
- Concrete Replacement at Sails Pavilion (\$3.9 million)
- New Cooling Tower—West Bldg. (WB) (\$1.6 million)
- Fire Safety Equipment: Water Cannons (\$1.7 million)
- Chiller Improvements (\$272,000)

The following three projects, totaling \$5.5 million, are currently in progress:

- Retrofit Escalators in WB (\$3.6 million)
- Fire/Life Safety System (\$1.3 million)
- Replace Rooftop Chiller (\$619,000)

The I-Bank requires that all projects be completed by January 2019. All loan proceeds must be expended for capital projects by that time as a condition of the loan.



# City Agencies: Convention Center

## 10-Year Capital and O&M Projections

SDCCC’s Board recently approved an updated 10-Year Capital and O&M needs projection for FY 2019 through FY 2028. These projections are the result of condition assessments performed by SDCCC staff and consultants on major capital and maintenance needs. The projections provide cost estimates, show which projects need to be undertaken, and when they should be undertaken, in order to properly maintain the Convention Center facility. The table below presents projected annual capital and O&M figures. The rightmost column shows the total annual funding need.

It should be noted that these projections exclude capital projects planned to be financed with the I-Bank loan. SDCCC’s CFO indicates that an additional \$2 million has been included for each of the next five years to make needed improvements in the lobby and common areas. It is unclear whether there will be sufficient funding in the FY 2019 budget to undertake the \$7.9 million of capital and O&M projects called for in FY 2019.

<b>10-Year Projections for Infrastructure Capital and Operations &amp; Maintenance (O&amp;M) Projects*</b>			
<b>(\$ in millions)</b>			
<b>Year</b>	<b>Capital</b>	<b>O&amp;M</b>	<b>Total</b>
<b>FY 2019</b>	\$3.5	\$4.4	<b>\$7.9</b>
<b>FY 2020</b>	\$6.5	\$4.1	<b>\$10.6</b>
<b>FY 2021</b>	\$8.0	\$3.9	<b>\$11.9</b>
<b>FY 2022</b>	\$9.1	\$1.5	<b>\$10.6</b>
<b>FY 2023</b>	\$11.3	\$1.4	<b>\$12.7</b>
<b>FY 2024</b>	\$3.7	\$1.4	<b>\$5.1</b>
<b>FY 2025</b>	\$5.5	\$0.7	<b>\$6.2</b>
<b>FY 2026</b>	\$8.0	\$0.2	<b>\$8.2</b>
<b>FY 2027</b>	\$4.6	\$0.5	<b>\$5.1</b>
<b>FY 2028</b>	<u>\$5.1</u>	<u>\$0.1</u>	<u><b>\$5.2</b></u>
<b>Total:</b>	<b>\$65.3</b>	<b>\$18.2</b>	<b>\$83.5</b>

\*Excludes capital projects to be funded with I-Bank Loan

## Annual City Payments in support of the Convention Center—\$15.5M

The City makes annual payments totaling \$15.5 million for debt service, dewatering, and long-term marketing in support of the Convention Center. These annual payments are detailed in Volume 2 of the FY 2019 Proposed Budget (beginning on page 113).

The City makes annual debt service payments on the Convention Center Expansion Bonds that were issued in 1998 (the Bonds were subsequently refinanced in 2012) to almost double the size of the original Convention Center which opened in 1989. The annual debt service payment for the Bonds is approximately \$12.6 million in FY 2019. Annual debt service payments will continue at this level until the bonds mature in FY 2028. Additionally, the City pays for annual dewatering costs (\$840,000 in FY 2019) - dewatering removes unwanted groundwater from the site.

For several years, the City has budgeted a \$3.4 million annual support payment for SDCCC. SDCCC reports they used approximately \$1.9 million of the City’s contribution to pay the annual costs associated with a long-term Sales and Marketing Services Agreement with San Diego Tourism Authority (SDTA). SDTA is responsible for marketing the Convention Center and securing new, and recurring, commitments for future (18 months and out) convention and trade show events. The balance of the City’s annual support payment has been used to cover capital expenses at the Convention Center.

In the FY 2019 Proposed Budget, the City’s support payment has been reduced from \$3.4 million to \$2.1 million—an amount that will just cover the annual cost of the

# City Agencies: Convention Center

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recently approved long-term marketing contract with the SDTA. The \$1.3 million reduction puts additional pressure on SDCCC's operating budget and reserve to address the capital and O&M needs identified in their 10-year projections.

## **SDCCC's Go-Forward Ability to Cover its Annual Costs for Capital, O&M, and I-Bank Debt Service**

In recent years, the Convention Center has benefited from very high levels of building occupancy, booked events, and attendance. The robust activity at the facility has resulted in higher operating revenues (inclusive of the City's annual support payment). Operating revenues have grown by approximately 27% over the last 5 years. This, in turn, has enabled SDCCC's Board to approve budgets with higher reserves and increased investment in needed capital and O&M projects.

It may be more difficult for SDCCC to meet all of its fiscal needs going forward for the following reasons:

- SDCCC revenues could fall from recent record levels depending on the quality future bookings or if there were to be an economic downturn
- SDCCC's annual expenditure budget has increased in recent years reflecting more activity in the building
- The first full year of annual debt service on the I-Bank loan (\$1.7 million) will begin in FY 2020
- The total annual cost for identified capital and O&M projects increases significantly over next four years
- There is \$1.3 million reduction in the City's annual support payment

Going forward, it is unlikely that the Convention Center will be able to grow events/attendance and revenues enough to meet its reserve goal and also cover all of its capital, O&M, and debt service expenses.

## **Possible Ballot Measure to Expand and Modernize Convention Center**

In January 2018, a citizens initiative was launched to increase the City's Transient Occupancy Tax (TOT) to modernize and expand the Convention Center, and also generate revenue to alleviate homelessness and repair roads. If proponents are able to gather sufficient signatures, the "For a Better San Diego" measure will be considered by the voters in November 2018.

If approved by the voters, the measure appears to allow TOT proceeds dedicated to the Convention Center to be used for all costs and expenses associated with the maintenance, operation and repair of the Convention Center. Additionally, the measure allows for the payment of debt service associated with existing debt for capital improvements at the Convention Center. It is important to note that there would need to be sufficient cash flow from the proposed TOT increase to fund these expenses along with debt service on the contemplated long-term expansion bonds.

While we cannot predict whether the measure will 1) qualify for the ballot or 2) be supported by voters in the City, it does appear that the measure has the potential to address the identified capital needs at the Convention Center. If approved by the voters, the measure also has the potential to reduce or eliminate annual General Fund payments in support the Convention Center.